

Introduction To State Sales and Use Taxes

Introduction

Your company may be “doing business” in a state and not even realize it until it’s too late.

If you are doing business in a number of states you may be subject to closer scrutiny by state and municipal tax assessors as they increasingly monitor activity in their state and go after unpaid taxes to increase their revenue stream. Many companies who owe taxes may not be aware that they are required to pay taxes in these states or of the technicalities inherent in nexus tax issues, and the need for sound tax planning.

In order to understand state sales and use taxes, you must first have a general understanding of the term “nexus”.

Nexus describes the amount and degree of business activity that must be present before a state can tax an entity's income. If a taxpayer has nexus in a particular state, the taxpayer generally must pay and collect/remit taxes in that state. In general, nexus is created for income, and/or sales/use tax purposes, if an entity:

1. Derives income from sources within the state;
2. Owns or leases property in the state;
3. Employs personnel in the state (employees or independent contractors);
4. Has personnel (employees or independent contractors) travel to another state; or
5. Has capital or property in the state, including inventory in storage or on consignment.

The amount of activity or connection that is necessary to create nexus is defined specifically by state statute or case law and/or regulation and, consequently, varies significantly from state to state.

Sales Tax in Michigan

Michigan has had a sales tax since 1933.

The measure of this tax base is the gross proceeds from retail sale of tangible personal property for use or consumption. Also includes certain conditional and installment lease sales; sales to consumers of electricity, gas, and steam; and sales to persons in real estate construction and improvement business.

Certain sales with the following characteristics are exempt from taxation, as follows:

1. Exemptions based on status of purchaser:
 - 1.1. property not purchased for resale by various nonprofit organizations and used primarily to carry out the organization’s purposes;

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- 1.2. property sold to churches for noncommercial purposes and certain vans and buses used to
 - 1.3. transport persons for religious purposes;
 - 1.4. food sold to enrolled students by an educational institution not operated for profit;
 - 1.5. property affixed to the real estate of nonprofit hospitals and nonprofit housing, including
 - 1.6. county long-term medical care facilities;
 - 1.7. certain property sold to commercial radio and television station licensees;
 - 1.8. vehicles not purchased for resale which are used by nonprofit corporations organized exclusively to provide a community with ambulance or fire department service;
 - 1.9. property purchased with scrip by inmates in correctional or penal institutions;
 - 1.10. textbooks sold by a school to kindergarten through 12th grade students;
 - 1.11. vehicles which are purchased by nonresident active military personnel for titling in his or her home state;
 - 1.12. property purchased for use in a “qualified business activity” as defined in the Enterprise Zone Act;
 - 1.13. property sold to certain businesses engaged in a high technology activity;
 - 1.14. property sold to the federal government or to an instrumentality thereof;
 - 1.15. tangible personal property for fund-raising purposes purchased by certain nonprofit organizations with calendar year sales of less than \$5,000;
 - 1.16. trucks and trailers owned by motor carriers engaged in interstate commerce to the extent of out-of-state usage;
 - 1.17. passenger or cargo aircraft with a certified takeoff weight of at least 6,000 pounds, or parts and materials (except shop equipment or fuel) sold to a domestic air carrier;
 - 1.18. employees of restaurants for food provided by their employer;
 - 1.19. motor vehicles, recreational watercraft, snowmobiles, or all terrain vehicles, and mobile
 - 1.20. homes sold to resident tribal members if the purchased item is for personal use and is to be used on the resident tribal member’s tribe agreement area.
2. Exemptions based on item purchased:
- 2.1. copyrighted motion picture films, newspapers, and periodicals classified as second class mail;
 - 2.2. hearing aids, contact lenses if prescribed for a specific disease precluding the use of eyeglasses, prosthetic devices, and eyeglasses prescribed by an ophthalmologist, optometrist, or optician;
 - 2.3. prescription drugs for human use;
 - 2.4. food for human use not prepared for immediate consumption;
 - 2.5. beverage containers to the extent of any deposits;
 - 2.6. railroad cars, locomotives, and accessories;
 - 2.7. vehicles to the extent of any refund of the purchase price because the vehicle is returned

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- 2.8. pursuant to the automobile lemon law;
 - 2.9. commercial advertising elements;
 - 2.10. non-alcoholic beverages in sealed containers or food not artificially heated or cooled that
 - 2.11. are sold from a mobile facility or vending machine, except fresh fruit; tax may be paid on
 - 2.12. either sales of non-exempt vended food or sum of 45% of all vended sales other than carbonated beverages ;
 - 2.13. water delivered through water mains or in bulk tanks in amounts over 500 gallons;
 - 2.14. personal property for resale, for lease if rental receipts are subject to Use Tax, and for demonstration purposes;
 - 2.15. partial exemption (from two percentage points of the tax rate): sales for residential use of
 - 2.16. electricity, natural gas, and home heating fuel;
 - 2.17. investment coins and bullion;
 - 2.18. certain aircraft and aircraft parts temporarily located in Michigan;
3. Exemptions based on transaction type:
 - 3.1. certain food or tangible personal property purchased with federal food stamps;
 - 3.2. property which is part of a drop shipment;
 - 3.3. property which results in uncorrectable debt;
4. Exemptions based on status of seller:
 - 4.1. certain vending machine merchandise to the extent of any commissions paid to certain tax exempt organizations;
 - 4.2. property on an isolated basis by property owners not required to have Sales Tax license;
 - 4.3. property in corporate sponsor contracts sold by the organizing entity of the Ryder Cup, the Super Bowl, the Professional Golfers Association Championship, the men's college basketball championship, and the men's college hockey championship;
5. Exemptions based on the use of the property or service:
 - 5.1. tangible personal property purchased by a person engaged in constructing, altering, repairing, or improving real estate if it is to be affixed or made a structural part of a sanctuary;
 - 5.2. specially-ordered commercial vessels of at least 500 tons engaged in interstate commerce and fuel, provisions, and supplies therefore;
 - 5.3. property used in production of horticultural or agricultural products as a business enterprise;
 - 5.4. property used or consumed in industrial processing;

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- 5.5. certain property used to provide any combination of telecommunications services which are subject to the Use Tax;
- 5.6. certain products, equipment, machinery, and utilities used or consumed by an industrial laundry;
- 5.7. grain drying equipment and natural or propane gas used to fuel the equipment for agricultural purposes;
- 5.8. computer equipment for data transfer by companies whose business includes publishing doctoral dissertations and information archiving and sells the majority of its products to nonprofit organizations exempt from the federal income tax.

The tax rate is 6% (the state constitutional limitation). The Sales Tax can be considered two taxes, a 4% tax and a 2% tax. The 4% tax is established by law within the confines of a 4% limitation placed in the State Constitution. These percentage points are expressed as the maximum rate that may be set by the legislature. The voters approved the remaining 2% tax rate in 1994. Because the State Constitution states that this additional tax shall be imposed, the 2% tax is the minimum rate that must be levied by the legislature.

This tax is administered by the Michigan Department of Treasury.

Most taxpayers: payment is due by 15th day of month following sale, with discount for early remittance.

Very large taxpayers (those with sales tax liability, or use tax liability, or both, of \$720,000 or more during the prior calendar year): make two payments each month. Unlike most taxpayers, both payments are related to the sales of the current month. The first payment is due by the 15th of the month and is equal to the lesser of (a) 50% of the tax liability for the same month in the prior calendar year or (b) 50% of actual liability for current month reported, plus a reconciliation payment equal to the difference between previous month's liability minus tax already paid for that month. The second payment is due by the last day of the month and is equal to the lesser of (a) 50% of the tax liability for the same month in the prior calendar year or (b) 50% of actual liability for current month reported.

Under current state and federal law, purchases of merchandise by Michigan citizens from firms without a physical presence in the state do not carry with them the requirement that the business collect sales and use taxes and remit them to the state. Instead, consumers are liable for the tax and a mechanism is provided to remit the tax as part of filing the annual personal income tax.

Relatively little revenue is collected through this process (a little over \$4 million in 2005 compared with an estimated liability of about \$300 million). It should also be noted that some sellers who are not required to collect Michigan's tax do so as a service to their customers who would otherwise owe the tax plus penalties and interest if not paid on time.

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The issue of collecting sales and use taxes on purchases made from out-of-state firms has frustrated states around the country for many years. The Supreme Court found that states could not compel out-of-state firms to collect the tax and remit it to the states. Instead, in 1992 the United States Supreme Court found that the United States Congress could pass legislation providing a solution to the issue, because it has constitutional authority to regulate interstate commerce.

Since 2000, a national effort has been underway to solve the problem of remote sales. In order to make the assessment and collection of the taxes by merchants or agencies acting on states' behalf feasible, the states agreed to a number of simplifications, including making collection and filing of taxes more uniform, and a set of uniform definitions covering certain items that are considered by different states as taxable or exempt in different ways, hence the term tax simplification.

In 2004, Michigan enacted legislation (Public Acts 172-175) that contains the technical and administrative features needed to comply with the multi-state agreement. States participating in this effort have completed the required modifications in their individual state laws in numbers sufficient for the implementation of the collection process to begin. Collection involves third-party agencies performing the work needed to calculate individual state and local taxes due to each state. In May 2006, two private firms were contracted with to collect remote sales and use taxes on behalf of participating states. Collections began in July 2006 and have generated about \$10 million for Michigan, a small proportion of the total estimated under a fully operation program.

State Sales and Use Tax FAQ

What states impose sales/use tax?

Currently 45 states plus the District of Columbia impose a general sales tax. The five states without general sales taxes are: Alaska, Delaware, Montana, New Hampshire and Oregon. However, Alaska permits local sales taxes. Delaware imposes a rental and service tax. Most of the states also impose different excise, meal or lodging taxes even though they don't impose a general sale and use tax. Most states also impose a variety of local sales taxes including county, city, and transit taxes.

What is nexus?

Nexus, also known as sufficient physical presence, is the determining factor of whether an out-of-state business selling products into a state is liable for collecting the tax on sales in the state. Nexus is created if your company maintains a temporary or permanent presence of people (employees, service people or independent sales/service agents) or property (inventory, offices, warehouses). The temporary presence is created through traveling people visiting states to call on customers or prospects, trade show attendance, or consigned inventory in warehouses. Nexus is created once a substantial physical presence is established. Unfortunately, this is not clearly defined by each state and can vary from 1 day to a number of days in other states. Nexus means a business entity has

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established a direct or representational presence within a particular state or jurisdiction. This presence gives the state the right to require a company to pay or collect and remit certain taxes.

How do I know if I should be collecting tax in a state?

You are responsible for collecting and remitting sales tax to a jurisdiction if you have established substantial presence in the state of delivery. Once established, you have created nexus. The threshold for this presence differs from state to state and a company's presence in each state should be examined to determine if nexus has been established or not. A company clearly has nexus if there is a business location or there are employees living in or working in the state/jurisdiction. Once you establish nexus, you are required to register as a retailer with each state before collecting sales tax for that state.

What is the difference between sales tax and use tax?

The sales tax is imposed on retail transactions. It applies to all retail sales of tangible personal property, and in some states services, in the state. The use tax is imposed on consumers of tangible personal property that is used, consumed, or stored in this state. Consumer's use tax applies to purchases from out-of-state vendors that are not required to collect tax on their sales. Sales and Use tax generally applies to most leases of tangible personal property. The sales tax and the use tax are "mutually exclusive", which means either sales tax or use tax applies to a single transaction, but not both.

When making a sale, do you collect tax for the state that you are located in or the state where the customer is located?

You collect the tax for the state where the property is delivered to your customer. If the item is shipped to the customer, then tax applies for the delivery state. You should collect the tax only if you are registered to collect tax in that state. If the customer picks up the item at your location, tax should be collected for your state.

I'm making sales over the Internet. Do I have to collect sales tax on all the sales I make?

If you are selling goods over the Internet and your company has a presence in the state of delivery, your company has established nexus and will be required to register to collect sales tax on all taxable items regardless of method of order placement. Whether the order is placed over the Internet or through traditional means, if a company has nexus with the state in which the product is being shipped, sales tax should be billed and collected. For example, if a Pennsylvania company ships to Pennsylvania, there is nexus, and tax is collected. If the Pennsylvania company ships out of Pennsylvania, whether they collect sales tax or not depends on whether or not they have nexus with the state into which they are shipping.

Didn't the Internet Tax Freedom Act (ITFA) ban taxes on sales over the Internet?

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No. The Act prohibited new taxes on Internet access fees. Most states do not tax the access fee. The Act did not prohibit states from imposing taxes on transactions conducted over the Internet. The use tax is not a discriminatory tax since it applies to all vendors (mail order, Internet, out-of-state, home shopping) and taxes goods purchased outside the state in the same manner as goods purchased in the state. So regardless of not being charged tax on an item purchased over the Internet, you are still held personally liable for the use tax.

Why doesn't the out-of-state retailer collect the tax?

If the retailer is located out-of-state and does not have a physical location or other type of physical representation in the state, the state cannot require the retailer to collect their sales tax. However, some out-of-state retailers voluntarily collect the tax as a convenience to their customers. If the retailer does not collect the sales tax, the purchaser has the obligation to pay the use tax directly to the state where the property is used as long as the item is taxable.

If you do not have nexus and therefore do not collect/remit the tax, can you be held liable if the customer does not pay the tax?

It is the purchaser's responsibility to self accrue and remit use tax. There is no sales tax obligation for your company if you have not established nexus .

Can you collect and remit tax for a state even if not required to do so?

Yes, you can voluntarily register to collect and remit tax. But, you must register with the state prior to collecting the tax.

What is the Streamlined Sales Tax Project (SSTP)?

Streamlined Sales Tax is a national effort by state and local governments and the private sector to simplify and modernize sales and use tax collection and administration. This national effort produced the "Streamlined Sales and Use Tax Agreement." The mission of the Streamlined Sales Tax Project is to develop measures to design, test, and implement a sales and use tax system that radically simplifies sales and use taxes. The purpose is to establish uniform sales and use tax standards, modernize sale and use tax laws, and make the burden of compliance the same for all sellers and all types of commerce. The SSTP agreement is focused on improving sales and use tax administration for both local businesses and remote sellers for all types of commerce. The Project is created and comprised of participating governments of most of the 50 states and the District of Columbia. For updates on activities on SSTP, visit <http://www.salestaxinstitute.com/ycc-streamlined-sales-tax-status.jsp>. To find more on the SSTP agreement, visit the Streamlined Sales Tax Project website at <http://www.streamlinedsalestax.org/>.

What is a resale certificate and who can use one?

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Resale certificates are used by purchasers, when acquiring property for resale in its present form or as components of other property. They are also used to purchase taxable services that become a part of property for resale in some states. States that allow for resale exemptions either accept a state issued resale certificate or, in some cases, a multi-state certificate. A business which is registered for sales and use tax can use a resale certificate only when the merchandise being purchased is to be resold by the business. A business cannot use a resale certificate to purchase merchandise that they will use and consume in the conduct of business. Any merchandise obtained upon resale certificate is subject to sales and use tax if it is used or consumed by the purchaser in any manner, and must be reported and the tax paid thereon direct to the appropriate jurisdiction.

How are contractors' purchases taxed?

Generally speaking, contractors owe sales or use tax when buying materials to be incorporated into real property. Most states do not tax real property construction and services. However, some do. When contracted by agencies or organizations that qualify for a sales or use tax exemption, contractors are not always exempt. Each state needs to be reviewed individually. Contractors are generally not resellers of materials incorporated into real property; they are considered users and consumers of materials purchased for a job. However, the type of contract can change the tax implications.

Is a sales tax return required even if my sales equal zero?

Yes. Every business with a sales tax license is required to file a return even though no sales were made during the period covered by the return. However, if you have seasonal sales or your sales tax liability has declined, you may request less frequent filing from the state.

I am visiting from another country. Can I get a refund of sales taxes paid?

Generally, no refund of sales tax is available if you took possession of the item from the vendor with a given state. If however, you have the vendor ship the item to you outside the state, the sales tax generally will not apply. There are a few locations, including New Orleans where refunds do apply for purchases by international visitors.

Do states provide a list of what is and is not taxable in their state?

Within the laws in each state, the taxability of products and services is enumerated. There are publications that summarize the states' tax laws available through the various vendors that provide tax research materials. States also have websites that provide access to the laws and regulations in their state. Links to the states department of revenue websites are located at <http://www.taxadmin.org>